Rev. Rul. 66-295, 1966-2 C.B. 207

The acquisition with borrowed funds of oil and gas production payments from properties in which there is no ownership of working interests will not preclude exemption of an organization which otherwise meets the requirements for exemption from Federal income tax under section 501(c)(2) of the Internal Revenue Code of 1954.

Advice has been requested whether an activity described below will preclude exemption of an organization which otherwise meets the requirements for exemption from Federal income tax under section 501(c)(2) of the Internal Revenue Code of 1954.

An organization formed for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount, less expenses, to another organization exempt from Federal income tax under section 501(a) of the Code, derives income through the acquisition, with borrowed funds, of oil and gas production payments. The organization owns no working interests in oil properties. The excess of the so-called interest equivalent factor paid in connection with each oil production payment over the interest rate charged by the lender of the borrowed funds, a spread generally averaging between one-quarter and one-half of one percent on each production payment purchased, provides the funds for the organization's charitable program. The amounts so received by the organization, less expenses, are turned over to an organization described in section 401(a) of the Code, which is exempt from Federal income tax under section 501(a) of the Code.

The courts have uniformly held that the purchase of oil production payments in the manner described by an organization otherwise qualified for exemption from Federal income tax under section 501(a) of the Code does not constitute the conduct of trade or business for profit and does not affect the organization's exempt status. See Bright Star Foundation v. Campbell, 191 F.Supp. 845 (1960); Southwest Endowment Corp. v. U.S., 1 A.F.T.R.2d 1869, 58-2, U.S.T.C. 9577, First Dallas Charitable Corp. v. U.S., 11 A.F.T.R.2d 312, 63-1 U.S.T.C. 9117; Southwest Charitable Corp. v. U.S., 11 A.F.T.R.2d 313, 63-1 U.S.T.C. 9118, B.G.S. Foundation v. U.S., 11 A.F.T.R.2d 314, 63-1 U.S.T.C. 9116; and Foree Foundation v. U.S., 11 A.F.T.R.2d 314, 63-1 U.S.T.C. 9115.

The Service will follow the decisions in the cited cases. Accordingly, the subject organization is exempt from Federal income tax under section 501(c)(2) of the Code. See Revenue Ruling 66-296, page 215, this Bulletin, which holds that an organization obtaining its income in a similar manner is exempt from Federal income tax under section 501(c)(3) of the Code.

An organization which considers itself within the scope of this Revenue Ruling must, in order to establish exemption under

section 501(c)(2) of the Code, file an application on Form 1026, Exemption Application, with the District Director of Internal Revenue for the internal revenue district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the Income Tax Regulations.